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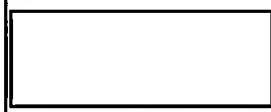
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25X1A ONE ARTICLE FROM OER'S ECONOMIC INTELLIGENCE WEEKLY REVIEW  
25X1A ENDING 15 DECEMBER 1978. REQUEST ARTICLE BE PASSED TO AMBASSADOR,  
DCM, ECONOMIC SECTION AND OTHER WORKING LEVEL STATE OFFICERS.

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CHILE: REFORM PROGRAM REVITALIZING THE ECONOMY.

(C).

1. THE PINOCHET GOVERNMENT'S THOROUGHGOING ECONOMIC REFORM PROGRAM HAS REVERSED ALLENDE'S SOCIALIST REVOLUTION AND TRANSFORMED CHILE INTO A MARKET-ORIENTED, FREE-TRADE ECONOMY. SANTIAGO HAS RESTORED ECONOMIC GROWTH, BROKEN HYPERINFLATION, AND AT LEAST TEMPORARILY ELIMINATED PAYMENTS PROBLEMS. INDUSTRY AND AGRICULTURE ARE BECOMING MORE INTERNATIONALLY COMPETITIVE, THE COUNTRY IS NOW LIVING WITHIN ITS MEANS, AND OVERRIDING DEPENDENCE ON COPPER EXPORTS HAS BEEN GREATLY REDUCED. WITH US BANKERS AND BUSINESSMEN IN THE VANGUARD, GROWING INTERNATIONAL BUSINESS CONFIDENCE IN THE JUNTA'S PROGRAM HAS PAVED THE WAY FOR NEW LOANS AND NEW DIRECT INVESTMENT, ENABLING THE JUNTA TO RELAX AUSTERITY POLICIES THAT HAVE HIT HARD AT THE POOR. (C).

2. THE US LETELIER INVESTIGATION, POSSIBLE ARMED CONFLICT WITH ARGENTINA, AND/OR THE REGIONAL INTER-AMERICAN LABOR ORGANIZATION'S PLANNED BOYCOTT OF

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CHILEAN PRODUCTS COULD TRIGGER INTERNATIONAL PAYMENTS PROBLEMS IN 1979. NONETHELESS WE EXPECT THE ECONOMIC GAINS AND STRUCTURAL IMPROVEMENTS OF THE REFORM PROGRAM TO CONTINUE APACE, TO MAINTAIN ECONOMIC GROWTH IN THE 6-PERCENT TO 7-PERCENT RANGE BEYOND NEXT YEAR THE CHILIAN JUNTA MUST TAKE STEPS TO BOOST DOMESTIC SAVINGS AND INVESTMENT FROM THEIR STILL RELATIVELY LOW LEVELS.

DRAMATIC TURNAROUND.

3. THE CHILEAN ECONOMY HAS RECOVERED FROM THE CHAOS OF THE LAST YEARS OF THE ALLENDE GOVERNMENT. COMPREHENSIVE ECONOMIC REFORMS ALONG WITH STRINGENT AUSTERITY MEASURES HAVE BROUGHT INFLATION UNDER FIRM CONTROL, RESTORED CHILE'S ECONOMIC CREDIT RATING, AND FOSTERED ECONOMIC GROWTH:

INFLATION IS DOWN FROM TRIPLE-DIGIT LEVELS IN THE MID-1970S TO 30 PERCENT IN 1978.

THE EXTERNAL ACCOUNTS WILL POST A \$500 MILLION SURPLUS THIS YEAR COMPARED WITH THE \$100 MILLION DEFICIT RECORDED IN 1973.

REAL ECONOMIC GROWTH IN 1978 WILL HIT ABOUT 6 PERCENT IN CONTRAST TO A 4-PERCENT DECLINE IN 1973. (C)

REFORM PROGRAM.

4. THE JUNTA A REFORM PROGRAM HAS TOUCHED EVERY ASPECT OF THE ECONOMY. THE NEW ECONOMIC AUTHORITIES--A GROUP OF ORTHODOX ECONOMISTS KNOWN AS THE "CHICAGO BOYS"--RESTRUCTURED THE ECONOMY ALONG FREE-MARKET LINES. PRICES OF INDUSTRIAL PRODUCTS WERE DECONTROLLED TO ENCOURAGE PRODUCTION AND ELIMINATE BLACK MARKETS. AT THE SAME TIME, WAGE INCREASES WERE RESTRAINED AND STRICT LABOR DISCIPLINE IMPOSED. AGRICULTURAL PRODUCTION WAS BOOSTED BY ENDING LAND REFORM, RETURNING EXPROPRIATED FARMLANDS, FREEING CROP PRICES, AND IMPLEMENTING TECHNICAL ASSISTANCE PROGRAMS. TO REDUCE STATE INVOLVEMENT IN THE ECONOMY, THE GOVERNMENT SOLD OFF MOST NATIONALIZED

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FIRMS TO PRIVATE INVESTORS. POLICYMAKERS SLASHED GOVERNMENT SPENDING, ELIMINATED MOST SUBSIDIES FOR PUBLIC ENTERPRISES, AND REVAMPED THE TAX COLLECTION SYSTEM. MONETARY EXPANSION WAS CURTAILED DRastically. CAPITAL MARKETS WERE REHABILITATED BY ELIMINATING INTEREST RATE CONTROLS, INDEXING FINANCIAL INSTRUMENTS, AND REDUCING PUBLIC SECTOR BORROWINGS. (C)

5. THE MILITARY GOVERNMENT ALSO REESTABLISHED CHILE'S INTERNATIONAL CREDIT RATING AND IMPROVED ITS INTERNATIONAL PAYMENTS POSITION, TO REGAIN THE CONFIDENCE OF FOREIGN INVESTORS, SANTIAGO COMPENSATED THE FOREIGN OWNERS OF EXPROPRIATED COPPER HOLDINGS AND HAS MET THE \$1 BILLION ANNUAL DEBT SERVICE OBLIGATIONS SINCE 1976. THE GOVERNMENT HAS UNIFIED THE MULTIPLE EXCHANGE RATES TO ELIMINATE IMPLICIT EXPORT TAXES AND IMPORT SUBSIDIES. NONTRADITIONAL EXPORTS HAVE BEEN ENCOURAGED BY REVOKING EXCHANGE CONTROLS, DEVALUING THE PESO IN LINE WITH RELATIVE RATES OF INFLATION, REBATING VALUE-ADDED TAXES ON OVERSEAS SALES, AND EXPANDING EXPORT PROMOTION EFFORTS. BARRIERS TO FOREIGN DIRECT INVESTMENT WERE DROPPED, AND CHILE WITHDREW FROM THE ANDEAN PACT IN LATE 1976 TO FREE ITSELF FROM RESTRICTIVE REGULATIONS ON THIS INVESTMENT. (C)

6. SANTIAGO ALSO MOVED TO REVITALIZE THE INDUSTRIAL BASE AND TO GENERATE NEW JOBS. PRODUCTIVE EFFICIENCY IN THE INDUSTRIAL AND AGRICULTURAL SECTOR WAS FOSTERED BY OPENING CHILEAN MARKETS TO FOREIGN COMPETITION THROUGH A PROGRAM OF DISMANTLING IMPORT CONTROLS AND REDUCING TARIFF BARRIERS. TO ENCOURAGE EXPANSION AND MODERNIZATION, POLICYMAKERS INTRODUCED ACCELERATED DEPRECIATION, ELIMINATED RESTRICTIVE LABOR LEGISLATION, AND ENCOURAGED COOPERATIVE PRODUCER ASSOCIATIONS. SINCE 1976, THE ECONOMIC AUTHORITIES HAVE CHANNELLED SUBSIDIZED INVESTMENT CREDITS INTO FISHING, FORESTRY, AGRICULTURE, AND COPPER--SECTORS IN WHICH CHILE HAS THE GREATEST COMPARATIVE ADVANTAGE. EARLIER THIS YEAR, COMMERCIAL BANKS WERE PERMITTED TO MAKE MEDIUM-TERM LOANS, INCREASING THE AVAILABILITY OF INVESTMENT CREDIT FOR THE PRIVATE SECTOR. (C)

PROGRESS TO DATE.

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7. BEFORE THE REFORM PROGRAM COULD TAKE HOLD, CHILE'S PRECARIOUS PAYMENTS POSITION WAS FURTHER DAMAGED IN LATE 1974 BY THE 40-PERCENT PLUNGE IN AVERAGE COPPER PRICES AND THE QUADRUPLING OF OIL IMPORT PRICES. TO PREVENT A RUNAWAY DEFICIT, THE MILITARY GOVERNMENT IMPLEMENTED HARSH AUSTERITY MEASURES. DURING 1975, INDUSTRIAL PRODUCTION FELL 23 PERCENT, REAL GDP DECLINED 11 PERCENT, INFLATION HOVERED AT 340 PERCENT, AND UNEMPLOYMENT DOUBLED TO 19 PERCENT. SINCE MID-1976, THE JUNTA REFORM STRATEGY PLUS A CAUTIOUS EASING OF AUSTERITY HAVE SPURRED A COORDINATED RECOVERY. (C).

DOMESTIC ECONOMY GROWING.

8. CHILE HAS MANAGED STRONG ECONOMIC GAINS FOR THREE SUCCESSIVE YEARS. REAL GROWTH IS ESTIMATED AT 6 PERCENT THIS YEAR AFTER JUMPING 8.6 PERCENT IN 1977 AND 4.1 PERCENT IN 1976. THE INDUSTRIAL SECTOR IS LEADING THE ADVANCE. INDUSTRIAL PRODUCTION HAS INCREASED 32 PERCENT SINCE 1975, REFLECTING THE RECOVERY IN MANUFACTURING AND A REBOUND IN CONSTRUCTION. AGRICULTURAL OUTPUT ROSE 30 PERCENT IN 1976-77 BECAUSE OF INCREASED PLANTINGS AND IMPROVED YIELDS, BUT DROPPED 6 PERCENT THIS YEAR PARTLY BECAUSE OF BAD WEATHER. (C).

9. AS A RESULT OF TIGHT FISCAL AND MONETARY POLICIES, PRICE INCREASES HAVE SLOWED TO AN ANNUAL RATE OF 30 PERCENT, COMPARED WITH 64 PERCENT LAST YEAR AND 174 PERCENT IN 1976. THE BUDGET DEFICIT, WHICH TOTALED 23 PERCENT OF GDP IN 1973, HAS BEEN VIRTUALLY ELIMINATED, WHILE THE REAL GROWTH IN THE MONEY SUPPLY HAS BEEN HELD TO A 20-PERCENT ANNUAL RATE SINCE 1976. COMPETITION FROM IMPORTS AND THE STRETCHING OUT OF AUTOMATIC WAGE ADJUSTMENTS HAVE ALSO CONTRIBUTED TO THE REDUCTION IN THE RATE OF INFLATION. (C)

10. PARALLELING THE UPTURN IN ECONOMIC ACTIVITY, EMPLOYMENT HAS RISEN BY 6.7 PERCENT YEARLY SINCE 1975. UNEMPLOYMENT IN SANTIAGO HAS FALLEN TO 14 PERCENT FROM THE MARCH 1976 HIGH OF 19.8 PERCENT. REAL WAGES, WHICH

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PLUMMETED 23 PERCENT DURING THE 1973-75 PERIOD, HAVE NOW CLIMBED TO 45 PERCENT ABOVE THE 1976 LEVEL. (C).

PAYMENTS POSITION IMPROVED.

11. ALTHOUGH OFFICIAL LOANS FELL OFF IN PROTEST AGAINST THE JUNTA'S HUMAN RIGHTS PRACTICES, GROWING PRIVATE CAPITAL FLOWS HAVE ENABLED THE CHILEAN REGIME TO AVOID PAYMENTS PROBLEMS SINCE 1976. RESUMPTION OF LOANS AND DIRECT INVESTMENTS BY BANKS AND BUSINESSMEN THIS YEAR WILL INCREASE CAPITAL INFLOWS TO AN ESTIMATED \$2.1 BILLION, COMPARED WITH \$1.4 BILLION IN 1977. ON THE STRENGTH OF ITS REFURBISHED INTERNATIONAL CREDIT RATING, CHILE IS TAPPING WORLD MONEY MARKETS FOR \$1.5 BILLION IN LOANS THIS YEAR TO EXTEND ITS DEBT MATURITY STRUCTURE AND TO BUILD RESERVES. LAST MONTH, FOR EXAMPLE, MANUFACTURERS HANOVER RAISED \$370 MILLION FOR THE CENTRAL BANK IN THE FORM OF A 10-YEAR CREDIT AT 1-1/8 PERCENTAGE POINTS OVER THE LONDON INTERBANK RATE. US BANKS--CITICORP, MORGAN GUARANTY, CHASE, CHEMICAL--ARE UNDERWRITING THE BULK OF THE SYNDICATED CREDITS AND PROVIDING A SUBSTANTIAL SHARE OF DIRECT LOANS. US FINANCIAL INSTITUTIONS HELD AN ESTIMATED 45 PERCENT OF CHILE'S FOREIGN DEBT AT YEAREND 1977, AND THE SHARE HAS INCREASED THIS YEAR. (C).

12. GROWING CONFIDENCE IN THE JUNTA'S ABILITY TO MANAGE THE ECONOMY HAS ALSO LED TO AN EXPANSION OF DIRECT FOREIGN INVESTMENTS. SINCE 1976, POLICYMAKERS HAVE APPROVED AN ESTIMATED \$3 BILLION IN NEW FOREIGN INVESTMENT PROJECTS. KNOWN DIRECT INVESTMENT WILL TOTAL ABOUT \$150 MILLION IN 1978; US CORPORATIONS ACCOUNTED FOR APPROXIMATELY 80 PERCENT OF THIS TOTAL. THE \$110 MILLION PURCHASE OF THE DISPUTADA COPPER MINE BY EXXON MINERALS INTERNATIONAL REPRESENTS THE LARGEST US INVESTMENT, WHILE GOODYEAR TIRE, DIAMOND SHAMROCK, AND ATLANTIC RICHFIELD HAVE MADE SMALLER ACQUISITIONS. EUROPEAN FIRMS HAVE MADE SEVERAL INVESTMENTS IN MANUFACTURING, CANADIAN COMPANIES ARE PROSPECTING FOR NEW COPPER DEPOSITS, AND JAPANESE INTERESTS HAVE INVESTED IN THE FISHING INDUSTRY. (C).

13. DESPITE THE 14-PERCENT DECLINE IN COPPER

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EARNINGS SINCE 1976, CHILE'S EXPORTS HAVE INCREASED 12 PERCENT TO \$2.3 BILLION IN 1978. SHIPMENTS OF NONCOPPER PRODUCTS--SUCH AS FRUITS, LUMBER, FISH, PULP, AND WINE--HAVE INCREASED 51 PERCENT SINCE 1976. EXPORT GAINS AND THE INCREASED INFLOW OF FOREIGN CREDIT HAVE ENABLED SANTIAGO TO RELAX AUSTERITY PROGRAMS. AS A RESULT, IMPORTS HAVE INCREASED BY 64 PERCENT SINCE 1976, TO AN ESTIMATED \$2.6 BILLION. US EXPORTERS, THE COUNTRY'S LARGEST SUPPLIERS, HAVE NOT KEPT PACE WITH THESE GAINS; THEIR TRADE SHARE DECLINED TO 20.9 PERCENT IN AUGUST 1978, COMPARED WITH 23.8 PERCENT IN DECEMBER 1976. A SHARP FALLOFF IN US AGRICULTURAL SALES WAS ONLY PARTIALLY OFFSET BY GAINS IN SHIPMENTS OF MACHINERY AND CONSUMER GOODS. (C).

STRUCTURAL CHANGES.

14. ECONOMIC REFORMS ARE SLOWLY INTRODUCING STRUCTURAL CHANGES THAT SHOULD ENHANCE CHILE'S FUTURE GROWTH. TARIFF REDUCTIONS PROGRAMS ARE FOSTERING INDUSTRIAL EFFICIENCY. THE INDUSTRIAL SECTOR, CODDLED BEHIND PROTECTIVE TARIFFS SINCE THE 1930S, NOW PRODUCES ONLY 25 PERCENT OF REAL GDP, COMPARED WITH 31 PERCENT IN 1973. TO SURVIVE THE INDUSTRIAL SHAKEOUT, FIRMS HAVE CUT THEIR WORKFORCES, ADOPTED NEW TECHNOLOGY, AND IMPROVED MANAGEMENT. DESPITE FIERCE COMPETITION FROM IMPORTS, INDUSTRIAL PRODUCTION IN MOST SECTORS HAS RECOVERED TO HISTORIC HIGHS. EXPORTS OF INDUSTRIAL PRODUCTS INCREASED FROM 10 PERCENT OF INDUSTRIAL OUTPUT IN 1973 TO 23 PERCENT IN 1977. (U)

15. THE INTERPLAY BETWEEN MARKET AND GOVERNMENT INCENTIVES IS ENCOURAGING THE GROWTH OF CHILE'S AGRICULTURE. AGRICULTURAL PRODUCTION HAS SHIFTED AWAY FROM TRADITIONALLY SUBSIDIZED CROPS--SUGARBEETS, BARLEY, RAPESEED--TO MORE PROFITABLE ITEMS SUCH AS FRUITS, VEGETABLES, MEAT, AND DAIRY PRODUCTS. AS A RESULT, CHILE IS NOW A NET EXPORTER OF FOODSTUFFS, A SURPLUS ABOUT \$40 MILLION THIS YEAR COMPARING WITH THE \$470 MILLION IMPORT DEFICIT RECORDED IN 1973. (C).

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16. GOVERNMENT MODERNIZATION PROGRAMS COUPLED WITH INCENTIVES TO FOREIGN INVESTORS ARE REVITALIZING THE MINING SECTOR DESPITE LOW WORLD COPPER PRICES. IN PARTICULAR, THESE EFFORTS HAVE ENABLED CHILE TO INCREASE MINE PRODUCTION FROM INSTALLED MINE CAPACITY WHILE IMPROVING THE EFFICIENCY OF MINING OPERATIONS. SINCE 1975, THE CHILEAN COPPER CORPORATION, THE STATE FIRM THAT MANAGES THE LARGE MINES, HAS INVESTED ABOUT \$300 MILLION IN NEW EQUIPMENT AND COST-REDUCTION TECHNOLOGY. AS A RESULT, COPPER PRODUCTION INCREASED FROM 735,400 TONS IN 1973 TO 1.06 MILLION TONS IN 1977. THE RECOVERY OF BYPRODUCTS HAS RISEN, AND PRODUCTION COSTS HAVE DECLINED. MOREOVER, THE LIBERALIZED FOREIGN INVESTMENT CLIMATE IS SPURRING RENEWED FOREIGN INTEREST IN DEVELOPING CHILE'S COPPER RESERVES, ABOUT 20 PERCENT OF THE WORLD TOTAL. IN 1977, FOR EXAMPLE, AN US-CANADIAN CONSORTIUM SPENT \$5 MILLION IN STUDYING THE FEASIBILITY OF DEVELOPING THE QUEBRADA BLANCA COPPER DEPOSITS WHICH WILL REQUIRE A MINIMUM OF \$500 MILLION TO BRING INTO PRODUCTION. (C).

17. NEW EXPORT POLICIES ARE SPARKING THE GROWTH AND DIVERSIFICATION OF THE EXPORT BASE. DURING THE PAST FIVE YEARS, CHILE HAS TRIPLED THE NUMBER OF COMMODITIES SOLD ABROAD AND HAS ESTABLISHED NEW MARKETS, ESPECIALLY IN THE THIRD WORLD. LATIN AMERICA, FOR EXAMPLE, NOW ACCOUNTS FOR 30 PERCENT OF CHILE'S EXPORTS COMPARED WITH ONLY 12 PERCENT IN 1973. CHILEAN EXPORTERS HAVE ALSO ESTABLISHED A TOEHOLD IN THE OPEC COUNTRIES, AFRICA, AND THE FAR EAST. AS A RESULT, DEPENDENCE ON COPPER REVENUES DECLINED FROM 81 PERCENT OF EXPORTS IN 1973 TO 53 PERCENT IN 1977. EVEN IF COPPER PRICES IN 1977 HAD EQUALLED HISTORIC AVERAGES, COPPER WOULD HAVE ACCOUNTED FOR ONLY 63 PERCENT OF TOTAL EXPORTS. (U).

18. GOVERNMENT AUSTERITY AND NEW TAXES ARE GREATLY INCREASING THE PUBLIC RESOURCES AVAILABLE TO HELP FINANCE NEW INVESTMENT. INTRODUCTION OF A VALUE-ADDED TAX, INDEXATION OF TAX LIABILITIES, AND CRACKDOWN ON TAX EVASION HAVE DOUBLED GOVERNMENT REVENUES SINCE 1973. THESE MEASURES HAVE BEEN SUFFICIENT TO COVER PUBLIC CONSUMPTION AND GENERATE SAVINGS EQUAL TO 7.7 PERCENT OF GDP IN 1977. ABOUT ONE-HALF OF THESE SAVINGS ARE BEING CHANNELED INTO PRIVATE SECTOR PROJECTS SUCH AS AGRICULTURE AND COPPER. COMMERCIAL LOANS HAVE QUINTUPLED SINCE DECEMBER 1974 IN RESPONSE TO INCREASING CONFIDENCE AMONG

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PRIVATE ENTREPRENEURS, THE FALL IN MONTHLY INTEREST RATES FROM AN AVERAGE OF 16 PERCENT IN 1975 TO ABOUT 5 PERCENT THIS YEAR, AND A GRADUAL EASING IN RESERVE REQUIREMENTS. CHILEAN CORPORATIONS HAVE ALSO FOUND FOREIGN CAPITAL MARKETS RECEPTIVE TO MEDIUM- AND LONG-TERM CREDITS NECESSARY TO FINANCE INDUSTRIAL EXPANSION PROJECTS. (C)

CONTINUING TROUBLESPOTS.

19. THE POOR AND THE WORKERS, WHO HAVE BORNE THE BRUNT OF THE STABILIZATION PROGRAM, STILL REPRESENT A SOURCE OF POTENTIAL SOCIAL AND ECONOMIC UNREST. THE ABANDONMENT OF PRICE CONTROLS HAS RAISED THE COST OF ESSENTIAL GOODS, WHILE TARIFF REFORMS AND AUSTERITY MEASURES HAVE HELPED TO KEEP UNEMPLOYMENT AT A HIGH LEVEL. MOREOVER, A STUDY BY THE UNIVERSITY OF CHILE INDICATES THAT REAL EARNINGS OF MINERS, UTILITY WORKERS, AND GOVERNMENT EMPLOYEES HAS NOT YET REGAINED 1970 LEVELS. THE PINOCHET REGIME IS FORESTALLING SOCIAL UNREST BY RESTRICTING POLITICAL LIBERTIES, MAINTAINING STRICT LABOR DISCIPLINE, IMPLEMENTING A PUBLIC WORKS EMPLOYMENT PROGRAM, AND INCREASING SPENDING ON SOCIAL SERVICES FOR THE POOR. (C).

20. LABOR TROUBLE HAS FLARED THIS YEAR, HOWEVER. SINCE JULY, BLUE-COLLAR WORKERS HAVE BEEN DEMANDING HIGHER WAGES TO RECOUP LOST PURCHASING POWER. AT THE END OF JULY, LABORERS AT THE CHUQUICAMATA COPPER MINE PROTESTED THE EROSION OF WAGES AND BENEFITS AND THE ABSENCE OF TRADE UNION FREEDOMS. WORKERS AT THE OTHER LARGE COPPER MINES, AT THE HUACHIPATO STEEL COMPLEX, AND AT THE LOTA COAL MINES FOLLOWED THEIR EXAMPLE. DESPITE SOME ECONOMIC CONCESSIONS, THE GOVERNMENT HAS TAKEN A HARD-LINE APPROACH TOWARD LABOR. IN OCTOBER, FOR EXAMPLE, THE JUNTA DISSOLVED SEVEN TRADE UNION FEDERATIONS AND ANNOUNCED A GENERAL ELECTION TO REPLACE ALL INCUMBENT UNION LEADERS. IN THE LONGER TERM, A NEW CROP OF INEXPERIENCED LABOR LEADERS COULD CAUSE TROUBLE BY MAKING UNREALISTIC WAGE DEMANDS IF THE GOVERNMENT HONORS ITS PLEDGE TO RESTORE COLLECTIVE BARGAINING NEXT YEAR. (C).

21. INADEQUATE DOMESTIC SAVINGS AND THE CONSEQUENT SLUGGISH RATE OF NEW CAPITAL FORMATION ARE WORRYING POLICYMAKERS. THE

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LOW RATE OF TOTAL FIXED INVESTMENT, 11 PERCENT OF GDP LAST YEAR IS PRIMARILY THE RESULT OF (A) THE LOW LEVEL OF PRIVATE DOMESTIC SAVINGS AND (B) THE STILL SMALL CONTRIBUTION OF FOREIGN CAPITAL AN ESTIMATED 3.2 PERCENT OF GDP IN 1977. THE SLUGGISHNESS OF NEW INVESTMENT WILL POSE A LESS SERIOUS CONSTRAINT TO ECONOMIC GROWTH IN THE SHORT RUN BECAUSE OF THE AVAILABILITY OF CONSIDERABLE UNUSED INDUSTRIAL CAPACITY. UNLESS DOMESTIC SAVINGS CAN BE GREATLY INCREASED, HOWEVER, CHILE OVER THE LONGER PERIOD WILL HAVE TO DEPEND INCREASINGLY ON FOREIGN CAPITAL TO SUSTAIN GROWTH AND PREVENT SUBSTNATIAL INCREASED IN UNEMPLOYMENT. (C)

OUTLOOK.

22. IF SANTIAGO CAN MAINTAIN LABOR PEACE AND DEFUSE INTERNATIONAL TENSIONS, THE CHILEAN ECONOMY SHOULD MANAGE ANOTHER YEAR OF SOLID ECONOMIC GAINS. WE EXPECT REAL GROWTH TO INCREASE BY 7 PERCENT IN 1979, LED BY CONTINUED GROWTH IN MANUFACTURING OUTPUT, FURTHER RECOVERY IN CONSTRUCTION ACTIVITY, AND A REBOUND IN AGRICULTURAL PRODUCTION. INFLATION SHOULD FALL TO 20 PERCENT, AND THE RATE OF UNEMPLOYMENT SHOULD DIP BELOW 13 PERCENT BY YEAREND. (C).

23. LABOR WILL CONTINUE TO PRESS FOR HIGHER WAGES AND FEWER RESTRICTIONS. STRIKES ARE UNLIKELY IN THE NEXT SEVERAL MONTHS BECAUSE OF GOVERNMENT CONTROLS. MOREOVER, NEW CONCESSIONS TO LABOR DEMANDS SHOULD CALM GROWING WORKER RESTIVENESS. THIS MONTH, FOR EXAMPLE, THE GOVERNMENT DECREED A 12-PERCENT SALARY INCREASE FOR CHILEAN WORKERS. THIS SHOULD ADD ONLY MARGINALLY TO INFLATIONARY PRESSURES. (C).

24. CHILE'S EXTERNAL PAYMENTS POSITION WILL LIKELY DETERIORATE NEXT YEAR. ANTICIPATING THIS DEVELOPMENT, POLICYMAKERS HAVE NEARLY DOUBLED GROSS RESERVES OF INTERNATIONAL EXCHANGE (TO \$1.5 BILLION). THESE MEASURES ARE INTENDED AS PRECAUTIONS AGAINST THE POSSIBILITY OF (A) A CLASH WITH WASHINGTON OVER THE LETELIER INVESTIGATION, (B) AN ARMED CONFLICT WITH ARGENTINA OVER THE BEAGLE CHANNEL, AND (C) A \$150 MILLION LOSS IN EXPORT EARNINGS BECAUSE OF THE RECENTLY ANNOUNCED BOYCOTT OF CHILEAN PRODUCTS BY THE REGIONAL INTER-AMERICAN LABOR

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ORGANIZATION. (C).

25. WE EXPECT THAT CHILE'S GROSS FINANCIAL REQUIREMENTS WILL TOTAL \$1.7 BILLION IN 1979, UP 8 PERCENT OVER 1978. THE TRADE DEFICIT WILL PROBABLY WIDEN TO ABOUT \$360 MILLION, COMPARED WITH \$280 MILLION THIS YEAR, AS ECONOMIC RECOVERY SPURS INCREASED IMPORTS WHILE THE INTERNATIONAL BOYCOTT LIMITS EXPORT GAINS. DEBT SERVICING COSTS SHOULD TOTAL ABOUT \$1.3 BILLION, AN INCREASE OF 4 PERCENT COMPARED WITH 1978. DESPITE HIGHER CAPITAL INVESTMENTS, FOREIGN BORROWINGS ARE UNLIKELY TO MATCH LAST YEAR'S LEVEL. CHILEAN ENTITIES HAVE RUSHED TO COMPLETE MAJOR SYNDICATIONS THIS YEAR, AND APPARENTLY ONLY A FEW SMALL CREDITS REMAIN IN THE INTERNATIONAL PIPELINE. POLICYMAKERS WILL THEREFORE HAVE TO DRAW DOWN ACCUMULATED RESERVES TO FINANCE THE PAYMENTS GAP. (C)

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[REDACTED] CL BY 015319.

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